FORSYTH BARR

Summerset Group

OUTPERFORM

3Q19 Springs Into Action

Summerset Group (SUM) reported its 3Q19 unit sales which were up +11.5% underpinned by strong resales up +33% versus 3Q18 and it has signalled that demand remains robust and vacancy low. SUM is on track to hit our FY19 sales expectations and we have not changed our forecasts or target price. Our rating remains OUTPERFORM.

Resales volumes very positive as occupancy remains high

Resales volumes in 3Q19 were 88 units, up considerably on the 66 units in 3Q18, with SUM maintaining solid occupancy rates across its villages resulting in little vacant resales stock. This was SUM's strongest quarter for resales in two years. SUM's YTD resales volume is 75% of our FY19 forecast resales of 308 units indicating SUM is on track in FY19.

New sales broadly in line but requires elevated 4Q19

SUM sold 77 new units in 3Q19, in line with 82 in the pcp. This is slightly below our forecast run rate for FY19 new sales of 333 units, although SUM noted that presales for its three new villages have been strong supporting a lift in 4Q19. The 4Q is historically a strong sales period and this year it is helped by the timing of new stock. We require new sales of 120 units to hit our FY19 forecast, compared with the average 4Q sales over the last three years of 109 units.

No FY19 earnings guidance comments – development on track

The existing development guidance is 350 new units which implies a very busy 2H19. The near-term development focus is the remaining independent living units at Rototuna (Hamilton), Casebrook (Christchurch), Ellerslie (Auckland) and at its new villages at Kenepuru (Wellington), Richmond (Nelson) and Avonhead (Christchurch). The next news is likely the Environment Court decision on Lower Hutt which is expected shortly.

Aussie a new area of growth

SUM's large pipeline was inflated by the recent acquisition of its first Australian site in Melbourne raising its pipeline to 5,078 units. This move was well signalled and in line with its strategic direction, and we expect SUM to benefit from the high demand for an integrated full continuum of care village offering.

Figure 1. Quarterly Sales track

	3Q18	4Q18	FY18	1Q19	2Q19	3Q19	chg % 3Q yoy	2019 YTD Actual	%FY19 Achieved	FY19
New sales	82	112	339	71	65	77	-6.1%	213	64.0%	333
Resales	66	81	301	66	76	88	33.3%	230	74.7%	308
Total	**148**	**193**	**640**	**137**	**141**	**165**	11.5%	**443**	69.1%	**641**

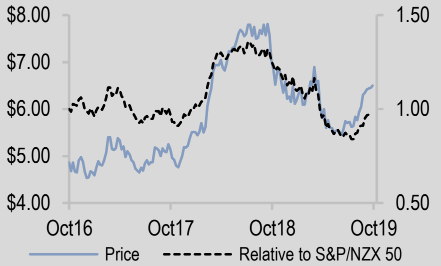
Source: Forsyth Barr analysis, Company Reports

Investment View

SUM continues to strengthen its development and operational track record and has a land bank of over six years. There remains significant long-term growth potential from demographic trends and SUM has the expertise to capitalise on these themes. Execution risk is increasing near-term as it tackles large and intensive Auckland developments late in the cycle but the business remains very well placed over the longer term. At current pricing SUM is getting very little credit for its operational and development track record since listing. OUTPERFORM.

NZX Code	SUM
Share price	NZ$6.50
Target price	NZ$7.20
Risk rating	High
Issued shares	225.8m
Market cap	NZ$1,467m
Average daily turnover	335.2k (NZ$2,009k)

Share Price Performance



Financials: December	18A	19E	20E	21E
NPAT* (NZ$m)	98.8	102.1	117.5	134.3
EPS* (NZc)	43.9	45.2	52.1	59.5
EPS growth* (%)	19.7	3.0	15.1	14.3
DPS (NZc)	13.2	13.6	15.6	17.9
Imputation (%)	0	0	0	0

Valuation (x)	18A	19E	20E	21E
EV/EBITDA	7.9	15.7	13.8	12.1
EV/EBIT	8.2	16.6	14.6	12.8
PE	14.8	14.4	12.5	10.9
Price / NTA	1.5	1.4	1.3	1.2
Cash dividend yield (%)	2.0	2.1	2.4	2.7
Gross dividend yield (%)	2.0	2.1	2.4	2.7

*Historic and forecast numbers based on underlying profits

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Summerset Group Holdings (SUM) Priced as at 09 Oct 2019: NZ$6.50 December year end

Forsyth Barr valuation			
Valuation methodology			DCF
12-month target price (NZ$)*	**7.20**	**Spot valuations (NZ$)**	
Expected share price return	10.8%	1. DCF	6.70
Net dividend yield	2.4%	2. n/a	n/a
Estimated 12-month return	13.1%	3. n/a	n/a
Key WACC assumptions		**DCF valuation summary (NZ$m)**	
Risk free rate	2.00%	Total firm value	1,997
Equity beta	0.88	(Net debt)/cash	(444)
WACC	7.7%	Value of equity	1,553
Terminal growth	1.5%	Shares (m)	226

Profit and Loss Account (NZ$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Sales revenue	186	347	247	283	321
Normalised EBITDA	**98**	**234**	**122**	**140**	**159**
Depreciation and amortisation	(5)	(7)	(7)	(8)	(9)
Normalised EBIT	**93**	**228**	**115**	**132**	**151**
Net interest	(12)	(12)	(13)	(15)	(16)
Associate income	-	-	-	-	-
Tax	(0)	(2)	-	-	-
Minority interests	-	-	-	-	-
Normalised NPAT	**82**	**99**	**102**	**118**	**134**
Abnormals/other	158	116	-	-	-
Reported NPAT	**240**	**215**	**102**	**118**	**134**
Normalised EPS (cps)	36.7	43.9	45.2	52.1	59.5
DPS (cps)	11.0	13.2	13.6	15.6	17.9

Growth Rates	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Revenue (%)	32.6	86.2	-28.7	14.2	13.5
EBITDA (%)	40.9	>100	-47.9	14.4	14.0
EBIT (%)	41.7	>100	-49.4	14.6	14.0
Normalised NPAT (%)	44.2	21.0	3.4	15.1	14.3
Normalised EPS (%)	42.8	19.7	3.0	15.1	14.3
DPS (%)	42.9	20.0	2.8	15.1	14.3

Cash Flow (NZ$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
EBITDA	**98**	**234**	**122**	**140**	**159**
Working capital change	110	(17)	118	183	241
Interest & tax paid	(13)	(13)	(13)	(15)	(16)
Other	0	-	-	-	-
Operating cash flow	**195**	**204**	**227**	**308**	**384**
Capital expenditure	(257)	(287)	(209)	(283)	(340)
(Acquisitions)/divestments	-	-	-	-	-
Other	-	-	-	-	-
Funding available/(required)	**(62)**	**(83)**	**18**	**26**	**44**
Dividends paid	(12)	(18)	(31)	(35)	(40)
Equity raised/(returned)	-	-	-	-	-
Increase/(decrease) in net debt	**75**	**100**	**13**	**10**	**(3)**

Balance Sheet (NZ$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Working capital	(26)	(57)	(48)	(55)	(62)
Fixed assets	2,193	2,718	3,011	3,387	3,835
Intangibles	6	7	7	7	7
Other assets	1	5	5	5	5
Total funds employed	**2,173**	**2,672**	**2,974**	**3,344**	**3,784**
Net debt/(cash)	340	445	458	468	465
Other non current liabilities	1,048	1,248	1,487	1,780	2,135
Shareholder's funds	786	979	1,028	1,096	1,184
Minority interests	-	-	-	-	-
Total funding sources	**2,173**	**2,672**	**2,974**	**3,344**	**3,784**

Valuation Ratios	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
EV/EBITDA (x)	18.1	7.9	15.7	13.8	12.1
EV/EBIT (x)	19.0	8.2	16.6	14.6	12.8
PE (x)	17.7	14.8	14.4	12.5	10.9
Price/NTA (x)	1.9	1.5	1.4	1.3	1.2
Free cash flow yield (%)	-4.3	-5.6	1.2	1.7	3.0
Net dividend yield (%)	1.7	2.0	2.1	2.4	2.7
Gross dividend yield (%)	1.7	2.0	2.1	2.4	2.7
Imputation (%)	0	0	0	0	0
Pay-out ratio (%)	30	30	30	30	30

Capital Structure	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Interest cover EBIT (x)	8.4	9.3	8.3	8.6	8.9
Interest cover EBITDA (x)	8.5	20.2	9.3	9.6	9.8
Net debt/ND+E (%)	30.2	31.3	30.8	29.9	28.2
Net debt/EBITDA (x)	3.5	1.9	3.8	3.4	2.9

Key Ratios	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Return on assets (%)	4.4	3.9	3.6	3.6	3.7
Return on equity (%)	10.4	10.1	9.9	10.7	11.3
Return on funds employed (%)	9.3	8.4	7.7	8.4	9.1
EBITDA margin (%)	52.5	67.6	49.3	49.4	49.6
EBIT margin (%)	50.0	65.7	46.6	46.8	47.0
Capex to sales (%)	138.2	82.7	84.6	100.0	106.1
Capex to depreciation (%)	5,564	4,293	3,092	3,742	3,991

Operating Performance	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Revenue (NZ$m)					
Care fees	75	91	105	118	131
Management fees	36	46	52	62	74
Other	0	0	-	-	-
Fair value m'ment in Investment Property (NZ$m)					
Realised	76	92	90	102	116
Unrealised	-	117	-	-	-
Total revenue	**186**	**347**	**247**	**283**	**321**
Key Drivers					
Sales - new units	382	339	333	400	480
Ave unit price - new sales (NZ$000s)	488	566	623	635	648
Sales - resold units	300	301	308	361	418
Ave unit price - resales (NZ$000s)	383	406	438	460	483
Gross development margin (%)	27.3	33.2	28.0	25.0	23.0
Gross resales margin (%)	21.7	23.5	24.0	23.0	22.0
New apartments/units	450	454	350	500	600
New beds	56	52	80	80	80
Portfolio					
Apartments/units	3,278	3,732	4,082	4,582	5,182
Beds	793	845	925	1,005	1,085

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Investment summary

With a strengthening development and sales track record, and a land bank of circa seven years, Summerset Group (SUM) has delivered to its 450 unit FY18 new build target. There remains significant growth potential from demographic trends, a further lift in its build rate and expansion into Australia with the acquisition of its first site in Victoria.

Business quality

- **Positive demographic trends:** SUM has the expertise to leverage the ageing population and growing popularity of retirement village living.
- **Growing development track record:** SUM built 450 units in FY18, and has achieved attractive development margins recently. Execution is becoming critical as SUM starts building larger high rise developments and increasing project debt.
- **Investing in quality of care:** SUM is investing heavily in its care operation which is increasing the 'needs based' nature of its portfolio and it has started adding dementia services to new developments.

Earnings and cash flow outlook

- **Strong underlying EPS growth track record:** Since listing on the NZX in 2011, SUM has generated strong EPS growth on a consistent basis. A key EPS driver will be SUM lifting its build rate over the medium term from 450 to 600 units per annum and expansion into Australia.
- **Recycling capital:** The occupational right agreement (ORA) structure provides the ability to self-fund development, subsidise the cost of a care facility, recycle capital into new development, and capture capital gains when units are resold.

Financial structure

- **Balance sheet:** Gearing has increased as SUM has rapidly lifted its build rate, and invested in higher priced metropolitan land, but debt remains largely project related.
- **Dividends:** SUM has been paying out a dividend at the low end of its 30%–50% target pay-out rate and has a dividend reinvestment plan in place.

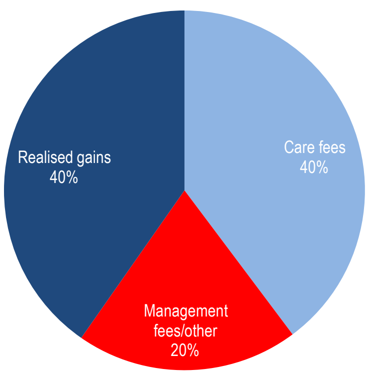
Risks factors

- **Oversupply:** The significant industry pipeline poses the threat of short-term oversupply, offset by a likely shortage of quality beds longer term.
- **Housing market downturn:** A downturn in the buoyant housing conditions is a threat to SUM's resales volumes, cash flows, and gearing.

Company description

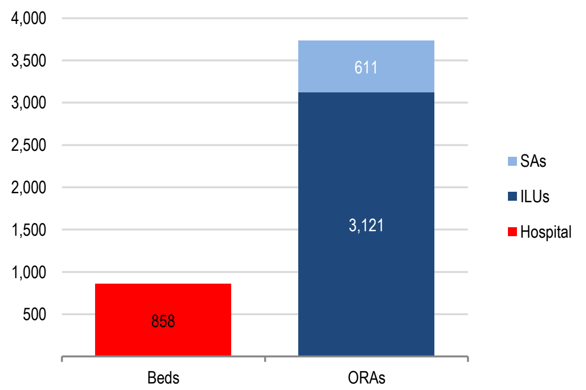
SUM is the second largest developer of integrated retirement villages in NZ. It offers a range of lifestyle options and aged care services for the long-stay care of the elderly. At 30 June 2019, it had a portfolio of 3,256 independent units, 615 Serviced and Memory Care apartments and 858 care beds across 24 operating villages. Although its care operations are the smaller part of its business, SUM has increased its focus on aged care services in recent years and continues to invest in this area. SUM was established in 1994 and listed on the NZX in November 2011.

Figure 2. SUM FY18 revenue mix (NZ$m)



Source: Forsyth Barr analysis, Company Reports

Figure 3. SUM portfolio as at 31 December 2018



Source: Forsyth Barr analysis, Company Reports

Figure 4. Substantial Shareholders

Shareholder	Latest Holding
Harbour Asset Management & Jarden Securities Limited	8.3%
Fisher Funds Management	6.2%

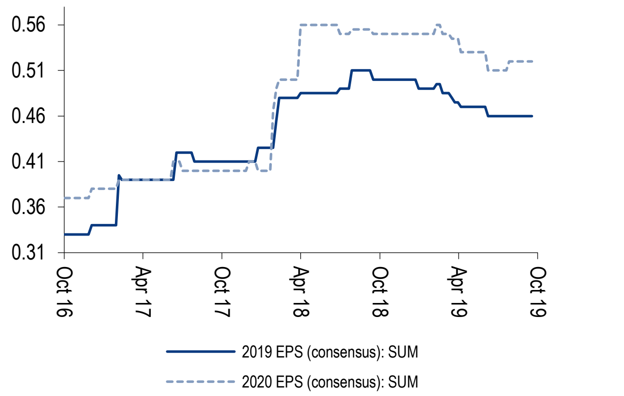
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 5. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect SUM's balance date - December)			(m)	2019E	2020E	2019E	2020E	2019E	2020E	2020E
Summerset Group	**SUM NZ**	**NZ$6.50**	**NZ$1,467**	**14.4x**	**12.5x**	**15.7x**	**13.7x**	**16.6x**	**14.5x**	**2.4%**
Metlifecare *	MET NZ	NZ$4.45	NZ$949	10.5x	10.1x	12.4x	11.9x	13.2x	12.7x	2.6%
Ryman Healthcare *	RYM NZ	NZ$12.93	NZ$6,465	25.9x	22.5x	26.0x	22.6x	28.4x	24.5x	2.2%
Oceania Healthcare *	OCA NZ	NZ$1.02	NZ$622	11.4x	10.4x	12.7x	11.6x	15.0x	13.6x	5.3%
Arvida Group Limited *	ARV NZ	NZ$1.46	NZ$791	14.0x	12.3x	15.6x	12.2x	17.2x	13.4x	4.5%
			Compco Average:	**15.4x**	**13.8x**	**16.7x**	**14.6x**	**18.4x**	**16.0x**	**3.7%**
EV = Current Market Cap + Actual Net Debt			**SUM Relative:**	**-7%**	**-10%**	**-6%**	**-6%**	**-10%**	**-10%**	**-34%**

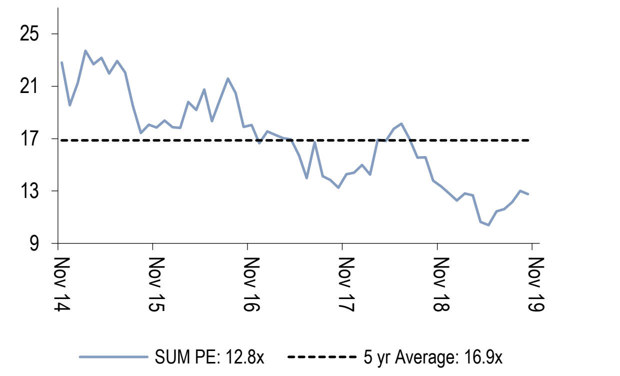
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SUM) companies fiscal year end

Figure 6. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 7. 12 Month Forward PE



Source: Forsyth Barr analysis